

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**DEFENSE LOGISTICS AGENCY
REVENUE ELIMINATIONS**

Report No. 96-198

July 22, 1996

Department of Defense

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Acronyms

CFO
DBOF
DFAS
DLA

Chief Financial Officers
Defense Business Operations Fund
Defense Finance and Accounting Service
Defense Logistics Agency



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884**

July 22, 1996

**MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
DIRECTOR, DEFENSE LOGISTICS AGENCY**

**SUBJECT: Audit Report on Defense Logistics Agency Revenue Eliminations
(Report No. 96-198)**

We are providing this audit report for information and use. We performed the review of intrafund eliminations as part of the Audit of Revenue Accounts in the FY 1996 Financial Statements of the Defense Business Operations Fund. This report is the second in a series of reports on revenue issues in the Defense Business Operations Fund. Management comments on a draft of this report were considered in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. David C. Funk, Audit Program Director, at (303) 676-7445 (DSN 926-7445) or Mr. Byron B. Harbert, Audit Project Manager, at (303) 676-7405 (DSN 926-7405). See Appendix D for the report distribution. The audit team members are listed inside the back cover.

A handwritten signature in black ink, reading "Robert J. Lieberman", is positioned above the typed name.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 96-198
(Project No. 5FD-2020.01)

July 22, 1996

Defense Logistics Agency Revenue Eliminations

Executive Summary

Introduction. The issue of revenue eliminations was identified during our work on the Defense Logistics Agency portion of the Audit of Revenue Accounts in the FY 1996 Financial Statements of the Defense Business Operations Fund (the Revenue Accounts audit). The Revenue Accounts audit was one of many actions initiated in response to the Chief Financial Officers Act of 1990 (Public Law 101-576, November 15, 1990), as amended by the Federal Financial Management Act of 1994 (Public Law 103-356, October 13, 1994). This report is the second in a series of reports on revenue issues in the Defense Business Operations Fund.

Audit Objectives. The overall objective of the Revenue Accounts audit was to determine whether revenues on the FY 1996 Consolidated Financial Statements of the Defense Business Operations Fund are presented fairly in accordance with the "other comprehensive basis of accounting" described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. Specifically, we determined whether revenues from sales to other Defense Business Operations Fund activities were eliminated in accordance with instructions issued by the Under Secretary of Defense (Comptroller). We also evaluated management controls over revenue eliminations.

Audit Results. When the Defense Logistics Agency made sales to other organizations that are part of the Defense Business Operations Fund, revenues from these sales were not eliminated from the amount reported in the FY 1995 financial statements, as required by guidance from the Under Secretary of Defense (Comptroller). Consequently, revenue of \$13.3 billion, reported by the Defense Logistics Agency in the FY 1995 Consolidated Financial Statements of the Defense Business Operations Fund, was overstated by \$8.4 billion (63 percent). Revenue was also overstated by \$.6 billion (4 percent) in the Defense Logistics Agency's financial statements.

We identified material management control weaknesses over the identification, reporting, and elimination of intrafund revenues, and over the reporting of data necessary for the preparation of accurate financial statements. See Appendix A for details.

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service Columbus Center, establish procedures to eliminate revenues from sales to intrafund customers when preparing the financial statements of the Defense Business Operations Fund. We also recommend that the Director, Defense Finance and Accounting Service Columbus Center, identify and report to the Defense Finance and Accounting Service Indianapolis Center the revenues to be eliminated when preparing the DoD consolidated financial statements. In addition, we recommend that the Director, Defense Logistics Agency, review the proposed financial statements, identify any deficiencies, and notify the Defense Finance and Accounting Service of the deficiencies and request correction.

Management Comments. The Defense Finance and Accounting Service concurred with the finding, but proposed alternative actions. The comments stated that actions are under way, in conjunction with the Elimination Entries Subgroup of the Governmentwide Financial Statements Task Force, to develop procedures to identify interfund and interagency transactions.

The Defense Logistics Agency nonconcurred with the finding but concurred with the recommendations. The response stated that the weakness in the accounting and disbursing systems as a control technique was not properly associated with the role of the Defense Logistics Agency. However, the response acknowledged that the Defense Logistics Agency was responsible for the overall accuracy of the financial statements. The Defense Logistics Agency implemented procedures to review the financial statements and requested that the Defense Finance and Accounting Service determine the feasibility of making the needed eliminating entries.

Audit Response. The alternative action proposed by the Defense Finance and Accounting Service is responsive to the recommendations. The actions taken by the Defense Logistics Agency are also responsive to the recommendations.

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Part I - Audit Results

Audit Background

The issue of eliminations was identified during our work on the Defense Logistics Agency (DLA) portion of the Audit of the Revenue Accounts in the FY 1996 Financial Statements of the Defense Business Operations Fund (the Revenue Accounts audit). The Revenue Accounts audit was required by the Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576, November 15, 1990), as amended by the Federal Financial Management Act of 1994 (Public Law 103-356, October 13, 1994). The CFO Act requires DoD to prepare, on an annual basis, audited financial statements for the preceding year and submit them to the Director, Office of Management and Budget (OMB). The statements report the financial position and results of operations of the DoD Components and business activities.

OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993, and the "DoD Guidance on Form and Content of Financial Statements for FY 1994/1995 Financial Activity," October 1994, assign responsibility and provide guidance for preparing financial statements required by the CFO Act. The DoD guidance on form and content and the "DoD Financial Management Regulation," DoD Regulation 7000.14-R, volume 6, chapter 15, February 1996 (the "DoD Financial Management Regulation"), state that the Defense Finance and Accounting Service (DFAS) and the DoD Components are jointly responsible for preparing and presenting the financial statements.

The DoD guidance requires that intrafund transactions be eliminated at three levels:

- o at the DoD Component level within DBOF,
- o from the DBOF consolidated financial statements, and
- o from the DoD consolidated financial statements.

The guidance requires that for an entity's financial statements, transactions internal to the entity must be eliminated from account balances reported in the statements. If the entity's financial statements are to be consolidated into the statements of a larger entity, the amount of eliminating entries applicable to the consolidation should be reported in a footnote to the statements.

For FY 1995, revenues for Defense Business Operations Fund (DBOF) activities in DLA were reported at \$13.3 billion. This total consists of revenues for the four business areas within DLA, as follows:

- o supply management, \$11.3 billion;
- o distribution depot, \$1.4 billion;
- o reutilization and marketing, \$.62 billion; and
- o industrial plant and equipment, \$13.3 million.

Audit Objectives

The overall objective of the Revenue Accounts audit was to determine whether revenues on the FY 1996 Consolidated Financial Statements of the DBOF are presented fairly in accordance with the "other comprehensive basis of accounting" described in OMB Bulletin No. 94-01. Specifically, we determined whether revenues from sales to other DBOF activities were eliminated in accordance with instructions issued by the Under Secretary of Defense (Comptroller). We also evaluated management controls over revenue eliminations. See Appendix A for a discussion of the audit scope and methodology and our review of the management control program.

Eliminating Entries for Defense Logistics Agency Revenues

Revenues from DLA sales to DBOF customers were not eliminated from the amount reported in the FY 1995 financial statements, as required by guidance from the Under Secretary of Defense (Comptroller). DFAS did not establish procedures to eliminate revenues from sales to DBOF customers because DFAS Columbus Center officials believed that the data required were not available. In addition, DLA officials accepted the revenue amounts presented in the financial statements without questioning DFAS officials about the inclusion of revenues that should have been eliminated. Consequently, revenue of \$13.3 billion reported by DLA for the DBOF Consolidated Financial Statements for FY 1995 was overstated by at least \$8.4 billion (63 percent). Revenue was also overstated by \$.6 billion (4 percent) in the DLA financial statements for FY 1995. These overstatements represent material management control weaknesses in the DFAS Columbus Center and DLA.

Need for Eliminations

The consolidated Statement of Operations for DBOF presents revenues, expenses, and net results of operations. DBOF revenues result from sales to outside customers who pay for goods and services with funds other than DBOF funds. Any sale between DBOF segments is an internal transaction that has no effect on the financial results of DBOF. Consequently, revenues resulting from sales within DBOF must be eliminated in determining the actual revenues earned by DBOF. Otherwise, revenues will be overstated. The accounting textbook, *Handbook of Modern Accounting*, states:

Fundamental to the preparation of consolidated financial statements is the need to eliminate or remove the effects of financial transactions or relationships among the components of the consolidated entity. In this way, the financial statements for the consolidated entity are guided by the same accounting principles that guide any financial statements - namely, that information (revenues, expenses, assets, liabilities, etc.) is reported based on transactions with outside parties.¹

¹Sidney Davidson and Roman L. Weil, *Handbook of Modern Accounting*, McGraw-Hill, New York, 1983, p. 34-3.

Preparation of Financial Statements

The DFAS Columbus Center compiles the financial data, including revenue information, for the DBOF financial statements. DLA receives this data from the DFAS Columbus Center and uses it to prepare the DLA financial statements for DBOF. The DLA statements are provided to the DFAS Indianapolis Center for inclusion in the consolidated DBOF financial statements. Beginning in FY 1996, DFAS will prepare financial statements that consolidate all DoD Components and business activities.

Procedures for Elimination

DFAS Columbus Center officials had not established procedures to identify amounts for elimination because they believed that the data were not available. However, data were available to identify the intrafund activity. We identified \$8.4 billion from the \$13.3 billion revenue total for DLA; the \$8.4 billion should have been eliminated from the DBOF Consolidated Financial Statements for FY 1995. Included in that amount was \$.6 billion of revenues that should have been eliminated from the DLA financial statements for FY 1995. Amounts in the Supply Management business area were identified for elimination by using the DoD interfund billing system, which identifies the customer's organization and the appropriation used to pay for the purchase. Amounts in the Distribution Depot business area were determined from summary data provided by a personal computer data base and from customer reimbursable orders² at the two distribution depot regions.

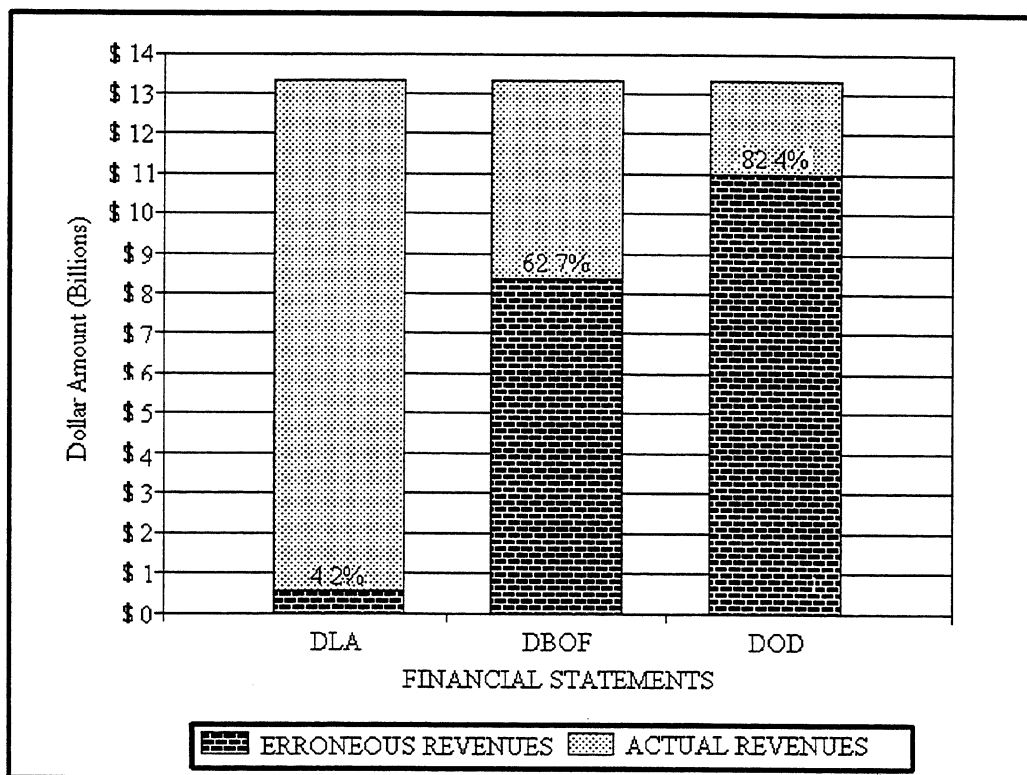
DoD-Wide Consolidated Financial Statements

The CFO Act, as amended, requires DoD-wide consolidated financial statements beginning in FY 1996. In these consolidated financial statements, DFAS will be required to identify and eliminate DBOF sales to DoD customers. In our review of DLA revenues reported in FY 1995, we identified \$11 billion (82 percent) of the \$13.3 billion in revenues that must be eliminated when preparing consolidated financial statements for DoD. Although the \$11 billion does not have to be reported for FY 1995, DFAS needs to establish procedures

²A customer reimbursable order occurs when one organization requests goods or services from another organization on a reimbursable basis.

Eliminating Entries for Defense Logistics Agency Revenues

to eliminate the DoD transactions in the FY 1996 consolidated statements. The chart below highlights the portion of each reporting level (DLA, DBOF, and DoD) in which revenues should be eliminated.



DLA Revenues for FY 1995 That Should Be Eliminated

Identifying Amounts to be Eliminated

DFAS can identify the DLA revenues to be eliminated by using manual procedures or by revising existing systems. We identified the amounts that should have been eliminated by manually extracting the information. This effort required no more than 120 staff hours. Less time will be needed if existing systems are modified to provide the information automatically.

Joint Responsibility for Financial Statements

The "DoD Financial Management Regulation" and the "DoD Guidance on Form and Content of Financial Statements for FY 1994/1995 Financial Activity" state that DFAS and the DoD Components are jointly responsible for ensuring that

financial statements are accurately prepared. DLA officials accepted, without question, the overstated revenue amounts provided by the DFAS Columbus Center.

Recommendations for Corrective Action

1. We recommend that the Director, Defense Finance and Accounting Service Columbus Center, eliminate applicable intrafund revenues from the FY 1996 financial statements by establishing:

a. Procedures for identifying and eliminating revenues that are internal to the Defense Logistics Agency and the Defense Business Operations Fund.

b. Procedures for identifying and reporting to the Defense Finance and Accounting Service Indianapolis Center the revenues to be eliminated when preparing the DoD consolidated financial statements.

Defense Finance and Accounting Service Comments. Responding for the Director, DFAS Columbus Center, the Deputy Director for Business Funds, Headquarters, DFAS, concurred with the finding but proposed alternative action. The comments stated, ". . . we do not concur that the DFAS Columbus Center should establish procedures to be applied to the Defense Logistics Agency financial statements." The comments also stated that actions are under way, in conjunction with the Elimination Entries Subgroup of the Governmentwide Financial Statements Task Force, to develop procedures to identify interfund and interagency transactions. The Deputy Chief Financial Officer, DoD, is developing procedures to be included in the "DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity."

Audit Response. The alternative action proposed by the Deputy Director for Business Funds, DFAS, is responsive to Recommendations 1.a. and 1.b.

2. We recommend that the Director, Defense Logistics Agency:

a. Implement procedures for reviewing and evaluating account balances and financial presentations provided by the Defense Finance and Accounting Service to determine whether the information presented is reasonable.

b. Notify the Defense Finance and Accounting Service when the financial statements appear to have material inaccuracies.

3. We recommend that the Director, Defense Logistics Agency, notify the Director, Defense Finance and Accounting Service, of any deficiencies in the proposed financial statements and request that the statements be corrected so that they meet all requirements.

Eliminating Entries for Defense Logistics Agency Revenues

Defense Logistics Agency Comments. Responding for the Director, the Principal Deputy Director, DLA, nonconcurred with the finding but concurred with the recommendations. His response stated that the weakness in the accounting and disbursing systems as a control technique was not properly associated with the role of the DLA. He further stated that the DLA was responsible for the overall accuracy of the financial statements and that, when DLA officials are aware of deficiencies in accounting systems, they disclose those deficiencies. Responding to Recommendations 2.a., 2.b., and 3., the Principal Deputy Director, DLA, stated that a financial analysis tool has been implemented to evaluate the monthly financial statements. In addition, the Office of the Comptroller, DLA, requested that the Director, DFAS, determine the feasibility of eliminating intrafund transactions from all applicable accounts in the financial statements.

Audit Response. The DLA actions are responsive to Recommendations 2.a., 2.b, and 3.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope

We reviewed revenue eliminations in conjunction with the Audit of Revenue Accounts in the FY 1996 Financial Statements of the Defense Business Operations Fund. The review included DLA's Supply Management and Distribution Depot business areas. These two business areas accounted for approximately 95 percent of DLA revenue for FY 1995.

<u>Business Area</u>	<u>FY 1995 Revenue</u>	<u>Percentage</u>
Supply Management	\$11.3 billion	<u>85</u>
Subtotal		<u>85</u>
Distribution Depot	1.4 billion	<u>10</u>
Subtotal		<u>95</u>
Reutilization and Marketing	0.62 billion	<u>5</u>
Subtotal		<u>100</u>
Industrial Plant and Equipment	<u>0.01 billion</u>	<u>0</u>
Total	\$13.33 billion	100

DLA Revenue for FY 1995 by Business Area

Methodology

We evaluated revenue eliminations by discussing procedures with DFAS Columbus Center personnel, and by reviewing the financial accounting systems of the Supply Management and Distribution Depot business areas. Where appropriate, we reviewed proposed changes to the systems to determine whether the data needed to identify and eliminate intrafund revenues were available.

For the Supply Management business area, we performed computations at the DFAS Columbus Center. To identify the revenues to be eliminated, we used

the Supply Automated Material Management System, the Defense Fuels Automated Management System, and the Defense Integrated Subsistence Management System.

For the Distribution Depot business area, we performed computations at the Defense Distribution Depot Regions East and West. To identify revenues to be eliminated, we used summary data from a personal computer data base and actual customer reimbursable orders.

Audit Period, Standards, and Locations. We performed the review of revenue eliminations from October 1995 through February 1996. Our review was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. To reach our conclusions, we used computer-processed data from three automated DoD systems and one personal computer data base. However, we did not test the reliability of the systems and data base. We included such tests of management controls as were considered necessary. Appendix C lists the organizations we visited or contacted.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed the adequacy of management controls at the DFAS Columbus Center and DLA over the preparation of financial statements. Specifically, we reviewed management controls over identifying, reporting, and eliminating intrafund revenues in the financial statements. We also reviewed the results of any self-evaluation of those management controls.

Adequacy of Management Controls. We identified material management control weaknesses at the DFAS Columbus Center and DLA, as defined by DoD Directive 5010.38. DFAS controls were not adequate to ensure that intrafund revenues were identified, reported, and eliminated. DLA controls were not adequate to ensure that the DFAS Columbus Center provided all data necessary to prepare accurate financial statements. These weaknesses are material at the DLA and corporate DBOF levels. A copy of the report will be provided to the senior officials responsible for management controls in DFAS and DLA.

Adequacy of Management's Self-Evaluation at the DFAS Columbus Center. DFAS Columbus Center officials identified the financial statements as an assessable unit, and correctly identified the risk associated with preparing the financial statements as high. However, DFAS Columbus Center officials did

Appendix A. Scope and Methodology

not identify the specific material management control weakness identified by our review because they did not review the accounting requirements for the financial statements.

Adequacy of Management's Self-Evaluation at DLA. DLA officials identified financial statements as an assessable unit; however, DLA assigned a low level of risk to that assessable unit. DLA considered the area to be low-risk and did no further testing. DLA should have assigned a high level of risk to the area and should have evaluated the applicable management controls. Because DLA did not conduct an evaluation, DLA did not identify or report the material management control weakness identified by our review.

Appendix B. Prior Audits and Other Reviews

Inspector General, Department of Defense. IG, DoD, Audit Report No. 96-021, "Defense Finance and Accounting Service Work on the FY 1994 Air Force Defense Business Operations Fund Financial Statements," was issued on November 6, 1995. The report stated that a DFAS Denver Center entry to eliminate intrafund accounts payable was not supported by accounting information. The general ledger accounting system did not maintain subsidiary ledgers that identified intrafund accounts payable. The report recommended that the Under Secretary of Defense (Comptroller) revise the DoD guidance and that the Director, DFAS, establish and maintain a subsidiary ledger for accounts receivable. Comments from the Under Secretary of Defense (Comptroller) were nonresponsive. The Deputy Director for Business Funds, DFAS, nonconcurred with the recommendation to establish and maintain subsidiary ledgers for accounts receivable. We requested that management reconsider its position. The IG, DoD, will evaluate this matter further in future audits.

IG, DoD, Audit Report No. 95-294, "Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994," was issued on August 18, 1995. The report discussed inadequate accounting for intrafund transactions. In several situations, the mechanisms used to track and account for these transactions were nonexistent or only partially developed. The report contained no recommendations.

Appendix C. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Director for Accounting Policy, Washington, DC

Defense Agencies

Defense Finance and Accounting Service, Arlington, VA
Defense Finance and Accounting Service Center, Columbus, OH
Defense Logistics Agency, Fort Belvoir, VA
Defense Distribution Depot Region East, New Cumberland, PA
Defense Distribution Depot Region West, Stockton, CA
Defense Logistics Agency Systems Design Center, Columbus, OH

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Acquisition and Technology)
Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Director, Accounting Policy
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Director (Audit Liaison and Follow-up)
Auditor General, Department of the Air Force
Financial and Support Audits Directorate
Acquisition and Logistics Audits Directorate

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Columbus Center
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, National Security Agency

Non-Defense Organizations

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Defense Finance and Accounting Service Comments



DFAS-HQ/AD

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

JUN 4 1996

MEMORANDUM FOR ACTING DIRECTOR, FINANCE AND ACCOUNTING
DIRECTORATE, INSPECTOR GENERAL, DOD

SUBJECT: Audit Report on Defense Logistics Agency (DLA) Revenue
Eliminations (Project No. 5FD-2020.01)

In your memorandum to the Director, Defense Finance and
Accounting Service (DFAS) dated April 11, 1996, subject as above,
you requested comments to recommendations in the draft report
which were directed to DFAS. Our comments are attached.

My point of contact is Mr. William J. deBardelaben. He may
be contacted on (703) 607-1581.


Edward A. Harris

Deputy Director for Business Funds

Attachment

DoD IG Audit Report on Defense Logistics Agency (DLA) Revenue
Eliminations (Project No. 5FD-2020.01)

- Recommendation 1.a. We recommend that the Director, Defense Finance and Accounting Service (DFAS) - Columbus Center eliminate applicable intrafund revenues from the FY 1996 financial statements by establishing procedures to identify and eliminate revenues that are internal to the DLA and the Defense Business Operations Fund.

- DFAS Comment. Partially Concur. We concur with the DoD (IG) that procedures are required for elimination of intrafund revenue, as well as other intrafund transactions, from the DBOF financial statements. However, we do not concur that the DFAS-Columbus Center should establish procedures to be applied only to DLA Financial Statements. The Office of the Deputy Chief Financial Officer, DoD, currently is working with the Eliminations Entries Subgroup of the Government-wide Financial Statements Task Force to develop procedures to identify interfund and interagency transactions. Applicable procedures, for implementation on a government-wide basis, are expected to be presented to the Task Force for implementation beginning with the reporting of fiscal year 1997 financial activity. For fiscal year 1996, the ODCFO is developing procedures that will be included in the draft "DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity" scheduled for release June 1996.

- Recommendation 1.b. We recommend that the Director, DFAS-CO eliminate applicable intrafund revenues from the FY 1996 financial statements by establishing procedures to identify and report to the DFAS-Indianapolis Center revenues to be eliminated when preparing the DoD consolidated financial statements.

- DFAS Comment. Partially Concur. See comments to recommendation 1.a.

Attachment

Defense Logistics Agency Comments



DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221

REPLY
REFER TO

DDAI


JUN 05 1996

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: Draft Report on the Defense Logistics Agency Revenue Eliminations,
SFD-2020.01

Enclosed is our response to your request of 11 April 1996. The DDAI point of contact is
LaVaeda Coulter, 767-6261.

Encl


JACQUELINE G. BRYANT
Chief, Internal Review Office

cc:
FOX

SUBJECT: Draft Report on the Defense Logistics Agency Revenue Eliminations, 5FD-2020.01

FINDING: Revenues from DLA sales to DBOF customers were not eliminated from the amount reported in the FY 1995 financial statements, as required by guidance from the Under Secretary of Defense (Comptroller). Procedures were not established to eliminate revenues from sales to DBOF customers because DFAS Columbus Center officials believed that the data required were not available. In addition, DLA officials accepted the revenue amounts presented in the financial statements without questioning DFAS officials about the inclusion of revenues that should have been eliminated. Consequently, the revenue of \$13.3 billion reported by DLA for inclusion in the DBOF consolidated financial statements for FY 1995 was overstated by at least \$8.4 billion (63 percent). Revenue was also overstated by \$.6 billion (4 percent) in the DLA financial statements for FY 1995. These overstatements represent material management control weaknesses in the DFAS Columbus Center and DLA.

DLA Comments: We disagree that DLA controls were not adequate to ensure that DFAS Columbus Center provided all data necessary to prepare accurate financial statements.

A vulnerability assessment was made of our role in the preparation of financial statements. We did not consider the weakness in the accounting and disbursing systems as a control technique properly associated with our role. We are responsible for the overall accuracy of the statements and when we are aware of accounting system deficiencies, we disclose them.

We recognized the problem and disclosed in the overview section (page 10) and the footnotes of our CFO report that, "DoD Guidance on Form and Content of Financial Statements for FY94/95 Financial Activity requires that intrafund transactions be identified and eliminated. However, current accounting systems used to record collections and disbursements have not been designed to identify and retain this information. Therefore, DLA business areas have not separately identified intrafund transactions."

The Department has also recognized the problem, as OSD stated in their March 1996 DBOF Status Reports, "The capability to identify and segregate intrafund transactions at the transaction level will require significant changes to the accounting system. In the interim, the Department will continue to eliminate intrafund balances manually from the consolidated CFO financial statements and take other feasible actions to improve the identification of intrafund transactions."

Internal Management Control Weakness: Nonconcur.

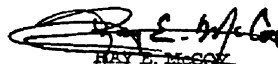
ACTION OFFICER: Richard Sninsky, FOX

PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller

COORDINATION: Eileen Sanchez, FOE
get, DDAI, to NAT 16

DLA APPROVAL:

JUN 3 1996


RAY E. MCCOY
Major General, USA
Principal Deputy Director

Defense Logistics Agency Comments

AUDIT TITLE: Defense Logistics Agency Revenue Eliminations, 5FD-2020.01

RECOMMENDATION 2.a: We recommend that the Director, Defense Logistics Agency implement procedures to review and evaluate account balances and financial presentations provided by the Defense Finance and Accounting Service to determine whether the information presented is reasonable.

DLA COMMENTS: Concur. We have instituted a financial analysis tool to evaluate our monthly financial statements. This tool uses reasonableness testing, trend analysis, and ratio analysis to promote financial statement accuracy.

DISPOSITION: Action is considered complete.

ACTION OFFICER: Richard Sninsky, FOX

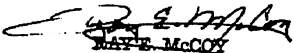
PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller

COORDINATION: LaVaeda Coulter, DDAI, 767-6261

OT, DDAI, 307019

DLA APPROVAL:

JN 3 1996


MARK E. MCCOY
Major General, USA
Principal Deputy Director

AUDIT TITLE: Defense Logistics Agency Revenue Eliminations, 5FD-2020.01

RECOMMENDATION 2.b: We recommend that the Director, Defense Logistics Agency notify the Defense Finance and Accounting Service when the financial statements appear to have material inaccuracies.

DLA COMMENTS: Concur.

DISPOSITION: Action is considered complete.

ACTION OFFICER: Richard Sninsky, FOX


PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller

COORDINATION: LaVaeda Coulter, DDAI, 767-6261

J.D. McCarthy, CAPT, SC, USN

DLA APPROVAL:

JUN 3 1996


RAY E. MCCOY
Major General, USA
Principal Deputy Director

Defense Logistics Agency Comments

AUDIT TITLE: Defense Logistics Agency Revenue Eliminations, 5FD-2020.01

RECOMMENDATION 3: Recommend that the Director, Defense Logistics Agency notify the Director, Defense Finance and Accounting Service, of any deficiencies in the proposed financial statements and request that the statements be corrected so that they meet all requirements.

DLA COMMENTS: Concur. Although this report only recommended the elimination of revenues, we provided the attached memorandum to DFAS to request them to determine the feasibility of eliminating all intrafund transactions.

DISPOSITION: Action is considered complete.

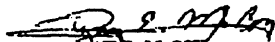
ACTION OFFICER: Richard Sninsky, FOX

PSE APPROVAL: J.D. McCarthy, CAPT, SC, USN, Comptroller

COORDINATION: LaVaeda Coulter, DDAI, 767-6261

J.D. McCarthy, 20 July 2020

DLA APPROVAL:



Major General, USA

Principal Deputy Director

FOX


MEMORANDUM FOR DIRECTOR DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Intrafund Eliminations

We have received a draft DoDIG audit report (Project No. 5FD-2020.01) that recommends the elimination of intrafund transactions. We ask that you determine the feasibility of removing the effects of intrafund transactions from the following accounts for all of our DBOF business areas and appropriated accounts:

- o Revenues & Expenses & Net Operating Results
- o Accounts Payable & Accounts Receivable
- o Disbursements & Collections (to include the undistributed)

Your assistance is greatly appreciated. If you have any questions, please call Richard Sninsky, (703) 767-6286.


B. A. BLACKMAN
Chief, Financial Policy, Systems
and Control Group
Office of Comptroller

R. Sninsky/09May96/767-6286/bmw/13May96
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Audit Team Members

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